In the Supreme Court of the United States

OCTOBER TERM, 1941

NO. . . . . .

JAMES DONEGHY and ST. LOUIS UNION TRUST COMPANY, Residuary Trustees Under Item 23 of the Last Will and Testament of James C. Doneghy, Deceased,
Petitioners,

VERSUS

ACEL C. ALEXANDER, Formerly Collector of Internal Revenue,
Respondent.

NO. . . . . .

JAMES DONEGHY and ST. LOUIS UNION TRUST COMPANY, Residuary Trustees Under Item 23 of the Last Will and Testament of James C. Doneghy, Deceased,
Petitioners,

VERSUS

H. C. JONES, Collector of Internal Revenue,
Respondent.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS OF THE TENTH CIRCUIT

BRIEF IN SUPPORT OF PETITION

I.

DECISIONS IN COURTS BELOW

These cases originated in the District Court of the United States for the Western District of Oklahoma. They are law actions which were triable by a jury, but in which

trial by jury was waived in writing and a trial had to the Court. The findings and decision of the trial court is not officially reported, but appears at pages 13 to 29 and 31 of the record.

The opinion of the Circuit Court of Appeals is reported in 118 Fed. (2d) 521, and appears at pages 111 to 115 of the record.

II.
STATEMENT OF THE CASE

A statement of the case containing all that is material to the consideration of the questions presented, with appropriate page references to the printed record, has been made in the petition for the writs herein and such statement is hereby adopted and made a part of this brief.

III.
ASSIGNMENT OF ERRORS

The petitioners make the following assignment of errors committed in the opinion and decision of the court below:

1. The Circuit Court of Appeals erred in that, after setting aside as clearly erroneous the finding of the trial court, that the 18⅛% beneficial interest in the Trust was a gift to the taxpayer, it did not remand the case to the trial court for further and corrected findings of fact or for other appropriate proceedings.

2. The Circuit Court of Appeals erred in that, after

setting aside as clearly erroneous the finding of the trial court that the 18⅛% beneficial interest in the Trust was a gift to the taxpayer, it did not remand the case to the trial court with directions to include the fair market value of that percentage of beneficial interest when acquired in the cost of his entire beneficial interest in the Trust and redetermine his loss on the sale of a part of that beneficial interest in 1930 and enter judgment accordingly.

3. The Circuit Court of Appeals erred in that after setting aside as clearly erroneous the findings of the trial court that the 18⅛% beneficial interest in the Trust was a gift to the taxpayer, it did not remand the case to the trial court for further proceedings, but instead made its own findings of fact upon a transcript of only a portion of the evidence and proceedings in the trial court and upon issues and questions not included in the trial court's findings and not passed on by the trial court, and upon its own findings based on such incomplete transcript affirmed the judgment of the trial court.

4. The Circuit Court of Appeals erred in holding that there was no proof in the record to sustain or support the taxpayer's claim that the 18⅛% beneficial interest in the Trust acquired by him in 1918 was in satisfaction of his claim against first the Doneghy Investment Company and then against the Trust as its successor, for compensation for services rendered by him under the contracts of February 23, 1904, and April 26, 1915, and in further holding that the record did not show for what consideration that additional beneficial interest was acquired, when the facts were

averred in the defendants' answers and admitted in the plaintiffs' replies that it was through an exchange of his share of the proceeds of the liquidation of the Doneghy Investment Company that he acquired the interest in the Trust held by him from April 26, 1915, throughout the year 1930.

5. The Circuit Court of Appeals erred in holding that the evidence before it in the transcript of a portion only of the evidence and proceedings upon the trial was sufficient to show that defendants had proven an estoppel against the plaintiffs which was not within the defendants' pleadings, and in affirming the judgment of the trial court on the basis of such estoppel when the trial court, with all the evidence and proceedings in the case before it, had found and held against such estoppel and the defendants as appellees had not filed a cross-appeal nor assigned any cross-error nor in any manner questioned the trial court's finding on the issue of an estoppel.

6. The Circuit Court of Appeals erred in holding that the evidence in the transcript of a portion only of the evidence and proceedings upon the trial brought up in the record before it was sufficient as a matter of law to support an estoppel of the plaintiffs to assert any cost to the taxpayer in the additional 18⅛% interest acquired by him in the Trust and in affirming the judgment of the trial court on the ground of such estoppel.

7. The Circuit Court of Appeals erred in that, after setting aside as clearly erroneous the finding of the trial court that the 18⅛% beneficial interest in the Trust was a

gift to the taxpayer, it proceeded, contrary to the uncontradicted evidence in the record that the right to receive that beneficial interest or its equivalent in value was earned by and had accrued to him prior to March 1, 1913, and was actually realized by him on liquidation of the Doneghy Investment Company in 1915, to find as a fact or to assume as a fact that said beneficial interest was a new acquisition to him in 1918 and its value was includable in his gross income for that year.

8. The Circuit Court of Appeals erred in not finding and holding that the right to receive the 18⅛% beneficial interest in the Trust or its equivalent in value was earned by and had accrued to the taxpayer prior to March 1, 1913, and hence was not subject to income tax, regardless of the year thereafter in which it was realized by him.

IV.

ARGUMENT

Synopsis of Argument

In support of the errors assigned the petitioners assert and rely on the following propositions which will be presented and considered in order:

1. The Circuit Court of Appeals, after rejecting the trial court's finding that the 18⅛% beneficial interest in the Trust was a gift to Doneghy, was bound either to remand the case for further and corrected findings by the trial court or, if it undertook to make its own findings, was

bound by facts averred and admitted in the pleadings and undisputed by anything in the record.

2. Estoppel is an affirmative defense and the burden of proving every essential element of it is on the one who asserts it and there is no evidence in this case that could under any view of the law support an estoppel against plaintiffs.

3. The property and rights in respect to property which Doneghy received on liquidation of the Company in 1915, comprising both compensation for services rendered and gain on his investment in stock in the Company, was not taxable income to him at any time, because his right to the compensation and the gain on his capital investment had accrued before and existed at March 1, 1913.

4. Under all the revenue acts compensation for services must be included in gross income, except where such compensation is the realization of a right to receive the same existing on March 1, 1913, and where services are paid for in property of any kind the fair market value of such property when received is the owner's cost basis therein for determining gain or loss on a sale thereof, and under the established facts in this case the decision and judgment of the Circuit Court of Appeals and of the trial court should be reversed by this Court with directions.

Proposition One

The Circuit Court of Appeals, after rejecting the trial court's finding that the 18⅛% beneficial interest in the Trust was a gift to Doneghy, was bound either to remand the case for further and corrected findings by the trial court or, if it undertook to make its own findings was bound by facts averred and admitted in the pleadings and undisputed by anything in the record.

These cases are actions at law in which trial by jury was waived in writing and the trial court undertook to make specific findings and to state separately its conclusions of law under the provisions of Rule 52(a) of the Federal Rules of Civil Procedure.

Just what power an Appellate Court has to reject findings of the trial court and make its own findings in a law case in which a jury is waived and the case tried to the court under the above rule is not clear. It probably is still the law, as it certainly was prior to the adoption of that rule, that in a law action tried to a jury or to the court without a jury the only matters open for review on appeal are (1) whether there was any evidence sufficient to support the trial court's findings and (2) whether the trial court's findings supported its judgment. The Appellate Court could not heretofore review the evidence and make its own findings independent of those of the trial court and either affirm or reverse the trial court upon its own fact findings. *McCaughn* v. *Real Estate Land Title Trust Co.*, 297 U. S. 606, 608; *State Farm Mut. Auto. Ins. Co.* v. *Coughran*, 303 U. S. 485, 487. In the latter case this Court said:

"Under applicable statutes and repeated rulings here, the matter open for consideration upon the appeal was whether the findings of the trial court supported its judgment. To review the evidence was beyond the competency of the court. 8 U. S. C. A., secs. 773, 875; *Walnut* v. *Wade*, 103 U. S. 683, 688, 26 L. ed. 526; *Stanley* v. *Bd. of Supervisors of Albany County*, 121 U. S. 535, 547, 7 S. Ct. 1234, 30 L. ed. 1000; *Law* v. *United States*, 266 U. S. 494, 496, 45 S. Ct. 175, 176, 69 L. ed. 401."

It is still settled law that a Circuit Court of Appeals is without power on review of proceedings of the Board of Tax Appeals to make any findings of fact and that the Board's findings of fact are conclusive, if there is evidence reasonably sufficient to support them.

Phillips v. *Commissioner*, 283 U. S. 589;

Burnett v. *Leininger*, 285 U. S. 136;

Helvering v. *Rankin*, 295 U. S. 123;

Gen. Utilities Oper. Co. v. *Helvering*, 296 U. S. 200;

Helvering v. *Kehoe*, 309 U. S. 277.

We know of no decided case holding that under said Rule 52 where the trial court has made specific findings the Appellate Court may not only reject those findings on the ground that they are not supported by the evidence, but also review the whole record and make its own findings of fact and base a decision affirming the trial court on its own findings.

In the instant case the trial court's finding that the 18⅛% beneficial interest in the Trust was a gift from the

other beneficiaries to Doneghy was not requested or suggested by either plaintiffs or defendants and was contrary to the pleadings and plainly was not the understanding and intention of those beneficiaries nor of Doneghy. The other beneficiaries when the contract of March 18, 1918, was entered into did not think they were making Doneghy a gift and he did not think he was receiving one. All of them intended to make and thought they did make a settlement and rearrangement of their several rights and interests in the property held by the Trust strictly according to the terms and provisions of their contracts dating back to February 23, 1904. So on the appeal both appellants and appellees agreed that the finding that this 18⅛% was a gift was wrong.

In passing it may be observed that the trial court's conclusion of law that the taxpayer had no cost basis in the 18⅛% because it was acquired by gift, was directly contrary to express statutory provision as well as the Treasury Regulations and an unbroken line of board and court decisions. Section 113(a)(4) of the Revenue Act of 1928; Art. 1562, Reg. 45; Art. 595, Reg. 74.

Obviously if the 18⅛% beneficial interest in the Trust was not a gift, there must have been a consideration for it. The Appeals Court said the taxpayer claimed it was compensation for services rendered but that there was "a complete absence of proof in the record to support or sustain" that claim and that the actual consideration might have been anything else, and what it was the record did not show (R.

114). On this statement that court bases one of its alternative grounds for affirming the trial court.

> Rule 52(a) provides that on appeal:
>
> "Findings of fact shall not be set aside unless clearly erroneous."

This empowers the Appellate Court to set aside erroneous findings of fact, but does not empower it to review the evidence and make its own findings of fact. Rightly interpreted it means that the Appellate Court can set aside erroneous findings of fact and remand the case to the trial court for appropriate proceedings to determine further and correct findings of fact.

Furthermore in the instant case only a partial transcript of the evidence and proceedings upon the trial (R. 42) was brought up in the record to the Appellate Court under the provisions of paragraphs (a), (d) and (e) of Rule 75 of the Federal Rules of Civil Procedure. The parties, or at least the appellants, deemed the part brought up sufficient to show the error of the trial court's judgment. On appeal they find that the error of the trial court is admitted and that the Appeals Court, after recognizing that error, proceeds to consider the partial transcript before it and to find and hold that the record fails to prove certain facts deemed essential to their case and does prove certain other facts not found by the trial court deemed fatal to their case.

> The defendant in each case in his answer averred:
>
> "That through an exchange of a share of the proceeds of the liquidation of Doneghy Investment Company plaintiff acquired the interest in J. C. Doneghy

> Trust held by him from April 26, 1915, until 1930, during which latter year the plaintiff sold a portion of his interest in the Trust."

In the reply of the plaintiffs to the answer of the defendant in each case it is said:

> "That they admit that it was through an exchange of his share of the proceeds of the liquidation of Doneghy Investment Company, including the portion of such proceeds distributed to him in compensation for services as above set forth, that J. C. Doneghy acquired the interest in the J. C. Doneghy Trust held by him from April 26, 1915, until 1930, in which year he sold a portion of his interest in said Trust."

We have here the specific allegation of defendants that all and whatever interest in the Trust was acquired by Doneghy was acquired by the exchange therefor of his share of the proceeds of the liquidation of the Company and the admission of this fact by the plaintiffs. In the light of this averment and admission no evidence was required to establish the fact as to how Doneghy came to acquire all the interest in the Trust that he ever had, nor would any have been admissible to show that the additional beneficial interest transferred to him in 1918 was acquired in any other manner or paid for from any other source. The plaintiff's contention that the 1918 contract merely changed the form of his interest in the Trust and did not give him any new acquisition is established by this pleading.

It is elementary that where a fact is alleged in the pleading of one party and specifically admitted in the pleading of the adverse party it is taken as true without the in-

troduction of evidence and is binding on the court as well as the parties. Indeed, the rule is further extended to the effect that an averment in a pleading to which a responsive pleading is required is deemed to be taken as true unless denied in such responsive pleading. Rule 8(d) of Federal Rules of Civil Procedure.

It would seem that the Appellate Court, even if it has become a fact-finding tribunal, when it does not have the whole record before it should remand the case for further proceedings in the trial court, in event that court's finding is set aside as erroneous.

Petitioners recognize the rule that if the decision below is correct, it must be affirmed on appeal, although the lower court relied upon a wrong ground or gave a wrong reason. But this rule has reference to errors of law where the facts are stipulated or are undisputed in the record or are found by the trial court upon sufficient evidence to support them. Such limitation of the rule is emphasized by the fact that it applies to the review of decisions of the Board of Tax Appeals whose fact findings are conclusive on the Circuit Courts of Appeals, if supported by any evidence. *Helvering* v. *Gowran,* 302 U. S. 238, 245-246. In the instant case the Appeals Court has set aside the fact finding on which the trial court based its decision, and then has affirmed that decision, not because the trial court gave the wrong reason for it, but upon a state of facts which it found or assumed from the incomplete record before it, and which the trial court did not find, but in part by necessary implication found adversely.

And if the Appellate Court has under Rule 52(a) become a fact-finding tribunal, then this Court, as the only court of review available, ought to review the question of whether there is any evidence in the record to support the findings of the Court. It is inherent in our judicial system that the findings of any fact-finding board, commission or tribunal should be subject to one review by an Appellate Court on the question of whether there is any evidence sufficient to support the facts found. This is an appropriate case for this Court to construe and apply Rule 52(a) and to settle the important question of federal law whether a Circuit Court of Appeals has the power to set aside an erroneous finding of the trial court and to proceed to make its own findings of fact on an incomplete record contrary to or different from those found by the trial court, or upon questions not passed on, and in respect of which no fact findings are made, by the trial court.

In any event the finding and holding of the court below that the record did not show how or for what consideration Doneghy acquired the 18⅛% beneficial interest in the Trust violates the settled and fundamental law that facts averred and admitted in the pleadings do not require proof and must be taken as true by the parties and the courts alike.

It would be an impertinence to present an array of authorities on this proposition.

In 21 R. C. L. 604, it is said:

"Proof is not required of an immaterial averment; of averments pleaded affirmatively by both parties;

of averments taken as confessed because of failure to deny them; or of facts otherwise admitted."

In *Wilcoxson* v. *Burton*, 27 Cal. 228, 87 Am. Dec. 66, it is held that a party is estopped by his pleadings from showing the averments therein contained to be untrue.

In *Landigan* v. *Mayer*, 32 Ore. 245, 51 Pac. 649, 67 A. S. R. 521, it is held to be error to admit evidence to dispute a material allegation that stands admitted by the pleadings.

A rather full discussion of the rule appears in *Pullman Co.* v. *Bullard* (5th C. C. A., 1930), 44 Fed. (2d) 347.

Without more we assert that the averment of a material fact solemnly made by a party in his pleadings and the truth thereof solemnly admitted by the adverse party in his pleadings is an established fact in the case. Not only is there no need to support it by evidence, but evidence offered in respect of it is not properly admissible. Nor can a court in its findings of fact disregard such admitted fact or make any finding contrary to it.

In the instant case the court below, assuming the function of the trial court as a fact-finding tribunal, and in the face of the contrary fact averred and admitted in the pleadings, said in reference to the 18⅛% additional interest in the Trust transferred to Doneghy that:

> "So far as the record speaks, he may have paid cash out of pocket for the increased interest, he may have exchanged property for it, or he may have acquired it in some other manner. The record does not tell, even sketchily, how it was acquired."

We respectfully assert that this statement, which is made the basis for that court's decision against petitioners on one of two alternative grounds, is flagrantly erroneous and in direct contravention of the admitted facts disclosed by the record. In basing its decision thereon, that court has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise by this Court of its power of supervision.

Proposition Two

Estoppel is an affirmative defense and the burden of proving every essential element of it is on the one who asserts it and there is no evidence in this case that could under any view of the law support an estoppel against plaintiffs.

Rule 8(c) of the Federal Rules of Civil Procedure enumerates the defenses which shall be set forth affirmatively in a pleading and estoppel is one of these.

In *Van Antwerp* v. *United States* (9th C. C. A., 1937), 92 Fed. (2d) 871, the Court, after stating that every essential element of an estoppel must be proven by the one relying on it, said:

> "These essential elements of estoppel, each of which the government must prove in this case, are set out in an authority cited in the government's brief:
>
> " 'To constitute estoppel (1) there must be false representation or wrongful misleading silence. (2) The error must originate in a statement of fact and not in an opinion or a statement of law. (3) The person claiming the benefits of estoppel must be ignorant of the true facts, and (4) be adversely affected by the acts or

statements of the person against whom an estoppel is claimed.'

U. S. v. *Scott & Sons* (C. C. A. 1), 69 Fed. (2d) 728, 732."

The following cases, all of which are tax cases, support this proposition and the above-cited case:

Helvering v. *Brooklyn City R. Co.* (2d C. C. A., 1934), 72 Fed. (2d) 274;

Salvage v. *Commissioner* (2d C. C. A., 1935), 76 Fed. (2d) 112;

Commissioner v. *Union Pac. R. Co.* (2d C. C. A., 1936), 86 Fed. (2d) 637;

Hull v. *Commissioner* (4th C. C. A., 1937), 87 Fed. (2d) 260;

Crossett Lbr. Co. v. *United States* (8th C. C. A., 1937), 87 Fed. (2d) 930;

Louis Werner Saw Mill Co. v. *Helvering* (Ct. App., D. C., 1938), 96 Fed. (2d) 539;

Helvering v. *Salvage* (1936), 297 U. S. 106;

McEachern v. *Rose* (1937), 302 U. S. 56.

While each of the foregoing cases fully sustains the proposition under consideration, the discussion in *Hull* v. *Commissioner* is particularly applicable here.

In the instant case the Appeals Court, after stating that if the taxpayer received 18⅛% beneficial interest in the Trust in 1918, it was his duty to show the value thereof as income on his return for that year, says:

"But he did not return any amount as such income

> in any year. His returns were consistently silent in respect of the matter, and limitation has long since run against correction of taxes arising out of the omission. Plaintiffs may not now take profitable advantage of such failure on the part of the taxpayer by asserting an increase in cost basis." (R. 115.)

The only fact in the record upon which that statement of fact and conclusion of an estoppel against the plaintiffs can be based is that Doneghy did not report as gain in 1918 the fair market value of the percentage of beneficial interest in the Trust which was transferred to him in that year. The only evidence in respect of his return for that year is the return itself (R. 87-89). Now if the apparent omission of the value of the beneficial interest in question from income on that return is a false representation, it was based on the taxpayer's interpretation of the law applicable. He contended then and ever after, and the plaintiffs contend now, that the value of this beneficial interest was not taxable gain or income to him in that year or in any year, but was merely a change in the form of his share in the assets of the Trust as fixed by the contracts of February 23, 1904, and April 26, 1915, to a percentage of beneficial interest in the corpus of the Trust, and that the rights he received in or in respect to the property of the Trust on liquidation of the Company in 1915 was his realization of earnings and capital gain which had accrued to him prior to March 1, 1913. This contention as to the law is supported elsewhere in this brief. And if he was in error in this view of the law, and if in fact the value of the percentage of interest in the corpus of the Trust acquired in 1918 should have been included in

income on his tax return, still there could be no estoppel against him, or the plaintiffs as his successors, based on his erroneous opinion of the law.

Furthermore, it does not appear that the Commissioner was ignorant of the true facts or acquiesced in the taxpayer's return in 1918 or was adversely affected by any omission of income on that return. The return as it appears in the record (R. 87) shows on its face that the Commissioner did not acquiesce in and accept it as filed, but that it was reviewed and audited and that some two years later additional tax in an amount four times as great as that shown and paid on the return was assesed against the taxpayer with a delay penalty.

In any event the burden was on the defendants to prove every essential element of an estoppel and the record is as silent as the tomb in respect of every element thereof other than the bald fact that the taxpayer's return for 1918 as filed did not purport to include any income realized by the acquisition of a further beneficial interest in the Trust.

In support of its holding the court below cites *R. H. Stearns Co.* v. *United States*, 291 U. S. 54; *Commissioner* v. *Farren* (10th C. C. A.), 82 Fed. (2d) 141; and *Alamo Nat'l Bank* v. *Commissioner* (5th C. C. A.), 95 Fed. (2d) 622.

An examination of *R. H. Stearns Co.* v. *United States* shows that its facts are so vastly different from those of the instant case that it cannot reasonably be said to have any application. There the taxpayer executed a waiver of limitation on assessment of taxes and delivered it to the Com-

missioner, and on the assumption that it was accepted by the Commissioner, received all the benefits of it. Then some six years after the whole matter had been closed, he sought to recover a refund of taxes on the ground that the waiver was void, because it had not been actually signed by the Commissioner. There could hardly be a stronger case of a taxpayer attempting to take advantage of the very thing he had procured the Commissioner to do for his benefit after he had reaped the benefits of it. There is nothing like that situation in the instant case.

In *Alamo National Bank* v. *Commissioner* the facts were that the taxpayer made return of the gain realized by him on liquidation of a corporation based on the value of certain assets distributed in kind and paid his tax accordingly. Then in a later year when he sold some of these assets, he sought to claim as his cost basis a larger value on them than he had claimed on his return in the year the corporation was liquidated. The Court properly held that he was estopped to do this. There is no similar fact situation in the instant case. In that case the Court cites, quotes and distinguishes *McEachern* v. *Rose*, *supra*, in which the rule here contended for was applied.

In *Commissioner* v. *Farren*, *supra*, and *Commissioner* v. *McCrary* consolidated with it, the facts were that certain corporate stock received by the taxpayers for services in the year 1918 had not been included at its market value in income on their returns. The Commissioner contended that they were estopped to claim any cost basis in this stock on the sale of it in a later year, because they had treated it as

having no market value in the year it was acquired. The Court based its decision in part on estoppel and in part on the proposition that the taxpayers had a cost basis in the stock when acquired different from its market value and that they had failed to prove this cost. In the opinion it is said:

> "The record here is silent as to cost; hence the taxpayer did not overcome the presumption that the Commissioner correctly computed the gain."

The writer of this brief was one of the attorneys for the respondents in the above cases. Petition for certiorari was applied for on the ground that the case was in conflict with the decision of the Second Circuit in the case of *Salvage* v. *Commissioner, supra,* which was affirmed by this Court in *Helvering* v. *Salvage, supra,* and with the decision of the Sixth Circuit in the case of *Robinson* v. *Commissioner,* 59 Fed. (2d) 1008. This Court granted certiorari. *Farren* v. *Commissioner,* 298 U. S. 653; *McCrary* v. *Commissioner,* 298 U. S. 653. After petitioner's briefs were filed and on August 11, 1936, Ellis N. Slack, an Assistant Attorney General of the United States, called the writer by telephone and said that, after having examined petitioners' briefs, the attorney general's office was doubtful that the decision of the Circuit Court of Appeals could be upheld, and suggested that we make an offer of settlement of the cases, and said that his office would recommend a settlement on the basis of 50% of the tax liability. After consultation with associate counsel and our clients an offer of 20% of the tax and interest in settlement was made. To this offer the attorney

general's office replied by telephone that a proposition to pay 25% would be accepted. We were averse to settling the case, because we were confident that the decision of the Circuit Court of Appeals was wrong and would be reversed, but our clients were afraid of the risk and preferred to protect themselves against a possible greater liability by settling on the 25% basis. So this settlement was agreed to and was carried out, and on October 26, 1936, the cases in the Supreme Court were: "Dismissed per stipulation of counsel." *Farren* v. *Commissioner*, 299 U. S. 617; *McCrary* v. *Commissioner*, 299 U. S. 617.

All communications from the attorney general's office in respect of this settlement were by telephone and the only writing signed by that office was the final stipulation of settlement. The taxpayers' liability turned upon a single and indivisible item and they owed all the tax in dispute or none. The settlement was a purely arbitrary one and the taxpayers merely purchased their release from the hazard of the cases by paying 25% of a possible liability in excess of $16,000 for each of them. The benefit to the Government was that it received 25% of a tax liability where it was entitled to nothing and that it had the benefit of the probably erroneous decision of the Circuit Court of Appeals as a precedent in its favor.

It is respectfully submitted that the Farren and McCrary decision is of doubtful value as a precedent and this Court could properly grant certiorari in this case for the purpose of settling the apparent conflict which still exists

between that decision and the Salvage and the Robinson cases and the others cited above on this proposition.

In income tax cases estoppel should be used sparingly and only where it is clearly established and its application will promote justice. In any instance its application violates the rule frequently announced and applied by the courts, including this Court, that income taxes are levied on the basis of an annual accounting period and income in one year should not be permitted to be transferred, either by the Commissioner or the taxpayer, to another year where it does not belong, for this will distort the income of both years and will subject the transferred income to the tax rate, whether higher or lower, of another year instead of to the rate applicable in the year in which it does belong. Errors of whatever nature in respect of income may properly be corrected only in the year in which they occur. *Newman* v. *Commissioner* (10th C. C. A.), 41 Fed. (2d) 743; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301; *Aluminum Casting Co.* v. *Routzahn*, 282 U. S. 92; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375.

And if income accruing in one year may by the application of estoppel, and on no other ground than that it was erroneously omitted from taxation in the year in which it belonged and that taxing it in that year is barred by limitation, be transferred to and taxed in some other year, then that is an effectual repeal of the applicable statute of limitations. This Court in a series of cases, beginning with *Bell* v. *Morrison*, 1 Peters 351, 360, decided in 1828, and including *United States* v. *Oregon Lumber Co.*, 260 U. S. 290, decided

in 1922, has held and emphasized that the defense of the statute of limitations is not a technical one, but is as substantial and meritorious as any other.

Proposition Three

The property and rights in respect to property which Doneghy received on liquidation of the Company in 1915, comprising both compensation for services rendered and gain on his investment in stock in the company, was not taxable income to him at any time, because his right to the compensation and the gain on his capital investment had accrued before and existed at March 1, 1913.

It is settled law that compensation for services earned prior to March 1, 1913, and gain unrealized but consisting in an increment in value over cost in any form of property prior to March 1, 1913, is not subject to taxation under any of the income tax Acts, when realized in a later year. Such gains are capital of the holder of the right to the compensation and owner of the property and it does not matter when after March 1, 1913, the compensation for the services is actually paid in money or property and the increment of gain in the property is realized by a sale or other disposition thereof.

This fact has been recognized in all the Treasury Regulations. Article 87 of Regulations 45 as amended by T. D. 3206, 5 C. B. 116, provides as follows:

> "*Art.* 87. *Income accruing prior to March 1, 1913.* Any liquidated claim existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not and held by a taxpayer prior to March 1, 1913,

whether evidenced by writing or not; and all interest which had accrued thereon before that date, do not constitute taxable income although actually recovered or received subsequent to such date. * * * Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued."

And Article 1548 of Regulations 45 as amended by T. D. 3206, 5 C. B. 46, provides as follows:

"*Art.* 1548. *Distribution in Liquidation.* So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payment for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder constitutes income to such stockholder. However, if such stock was acquired prior to March 1, 1913, and the fair market value as of such date was greater than the cost but less than the amount so distributed, the taxable income is the excess over such fair market value of the amount received, but no gain is recognized if the amount received, although more than cost, is less than the fair market value of the stock on March 1, 1913."

Article 90 of Regulations 62 restates Article 87 of Regulations 45 as amended by omitting the words "and then assignable," but without other change. As thus restated this regulation has been incorporated in all subsequent regulations. Art. 90, Reg. 65; Art. 90, Reg. 69; Art. 91, Reg. 74; Art. 90, Reg. 77.

In *Lynch* v. *Turrish* (8th C. C. A., 1916), 236 Fed. 653, a corporation liquidated in March, 1914, and the question was whether the amount that stockholders received in liquidation in excess of their original investment in their stock was taxable income. All the value of the corporate assets in excess of its capital stock had accrued prior to March 1, 1913. The Court, in a full discussion of the subject and presentation of authorities, held that none of this gain to the stockholders was taxable, because it had in fact accrued prior to March 1, 1913. Certiorari was granted by this Court and the decision of the Circuit Court of Appeals affirmed in *Lynch* v. *Turrish*, 247 U. S. 221. Neither of the foregoing cases has been overruled, modified or criticised in respect of the holding on the point here involved.

The facts of the instant case bring it squarely within the regulations and cases cited. The value of the assets of Doneghy Investment Company was found by the trial court, and this finding is nowhere questioned, to be the same on March 1, 1913, as on April 26, 1915 (R. 27), when the Company was liquidated and all of its assets distributed in a liquidating dividend. Under his contract of 1904 Doneghy was entitled to 50% of all the profits accruing in the conduct of the Company's business. True, his share of these profits may not have been payable until realized by sales of the Company's property, but if it had liquidated at March 1, 1913, as it did at April 26, 1915, and distributed its assets in a dividend in kind, he would then have been entitled, as he was entitled in 1915, to 50% of all the distribution in excess of the $80,000 paid-in capital as compensation for

services and to his proportionate part of the remainder as a stockholder. It was the intention and understanding of the parties concerned that the Trust created by them was to and did take and hold the assets of the liquidated company on precisely the same terms and precisely the same interests of ownership and of rights in respect to those assets as existed when they were held by the Company. This meant that the Company's stockholders, including Doneghy, owned $80,000 and 50% of the excess in value of Trust assets over $80,000 in the same proportions that they had owned stock is the Company, and that Doneghy equitably owned the other 50% in excess of $80,000 which was to be paid over to him as the lands of the Trust were converted into money. If the agreement of March 18, 1918, had been made effective on April 26, 1915, Doneghy would then have received 81⅞% beneficial interest in the Trust and the other beneficiaries 18⅛% thereof. So when the agreement of March 18, 1918, was actually made, it merely put into effect the original agreement of February 23, 1904 (R. 43), between Doneghy and the Company, and expressed in a different form the agreement of April 26, 1915, as to the rights and interests of the parties in respect of the property transferred to the Trust at that time.

At least Doneghy consistently made the contention in 1918 and at all times thereafter, and petitioners make it now in good faith, that as a matter of law he realized no gain, acquired nothing that he did not own or have the right to before, by the agreement of 1918. If it should perchance be decided that this view of the law is wrong, even so there

is no authority for an estoppel against the taxpayer's claim that the value of his interest in the Trust in 1918 was his cost basis on the sale of it simply because he did not return such value as income in that year due to an honest mistake in the law.

On this point see the cases cited under Proposition Two, *supra.*

Proposition Four

Under all the revenue acts compensation for services must be included in gross income, except where such compensation is the realization of a right to receive the same existing on March 1, 1913, and where services are paid for in property of any kind the fair market value of such property when received is the owner's cost basis therein for determining gain or loss on a sale thereof, and under the established facts in this case the decision and judgment of the Circuit Court of Appeals and of the trial court should be reversed by this Court with directions.

A part of this proposition probably will not be disputed by respondents. The first clause is approved by the court below in its decision and is supported by Section B(1) of the 1913 Act, Section 2(a)(1) of the 1916 Act, Section 213(a) of the 1918 Act, paragraphs 52 to 54 of Regulations 33 Revised, and Article 31 of Regulations 45.

The rule that where services were rendered prior to March 1, 1913, but paid for thereafter, the compensation received is not taxable income except as to the excess of the amount received over the fair market value on March 1, 1913, of the claim for such compensation, has been established under Proposition Three, *supra.*

Within the Regulations there cited a claim exists unconditionally on March 1, 1913, when the claimant's right to it is certain, even though the value of it on that date must be estimated and the amount that may ultimately be realized from it may be either greater or less than such estimated value, depending upon fluctuations or contingencies subsequent to that date.

The statement that the fair market value of property received for services is the owner's cost basis therein is supported by the following, with nothing to the contrary:

Article 33 of Regulations 45;

J. Heninger et al., 9 B. T. A. 1318;

William T. Bivim, 21 B. T. A. 1051;

E. D. Knight, 28 B. T. A. 188, 189;

James H. Torrens, 31 B. T. A. 787, 795.

On the established facts that Doneghy acquired his interest in the Trust upon liquidation of the Doneghy Investment Company in 1915, which interest was changed in form only and without any new acquisition in 1918, and upon the fact that the interest so acquired in 1915 was compensation for services rendered and for increment in value of stock owned prior to March 1, 1913, this Court ought to reverse the Circuit Court of Appeals and the trial court and direct the trial court to recompute the loss sustained as set out in its conclusion of law No. 3 (R. 29) by fixing the taxpayer's cost in his interest in the Trust at 50% of the excess of $531,819.58 over $80,000 and 63¾% of the remainder, or at 63¾% of $80,000 out of said $531,819.58 and 81⅞% of the remainder, both of which give the same result.

CONCLUSION

In conclusion the petitioners say that under the only reasonable interpretation of the facts of this case as shown by the record the taxpayer has been denied the benefit of the deduction of a portion of his actual cost in his beneficial interest in the Trust in determining his loss upon the sale of a portion of such interest in 1930. Earnings and gains on his investment dating as far back as 1904 have been subjected to tax by the judgments of the district court and the Circuit Court of Appeals in the year 1930 in violation of settled principles of law under the Sixteenth Amendment and the various Revenue Acts.

The courts below have failed to understand or failed to recognize the simple and fundamental facts on which the taxpayer's case is based and have applied erroneous rules of law in the determination and in the interpretation and application of the facts.

In order that justice may be done to petitioners and for the reasons and upon the authorities set forth herein, petitioners ask that this Court grant the writs of certiorari as prayed for and review the decisions of the courts below.

CHAS. H. GARNETT,
608 Hales Building,
Oklahoma City, Oklahoma,
Attorney for Petitioners.

⊙